



LEGAL DEPARTMENT

Writer's Direct line: 301-790-6283
FAX: 301-790-6460

10435 Downsville Pike
Hagerstown, MD 21740-1766
(301) 790-3400

February 6, 2003

VIA OVERNIGHT MAIL

Joel H. Peck, Clerk
Virginia State Corporation Commission
Document Control Center, Level B1
Tyler Building
1300 E. Main Street
Richmond, Virginia 23219

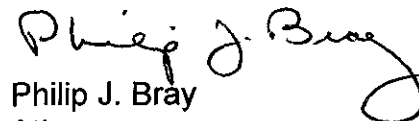
Re: In the Matter Concerning the Provision of Default Service to
Retail Customers Under the Provisions of the Virginia Electric Utility Restructuring Act
Va. SCC Case No. PUE-2002-00645

Dear Mr. Peck:

As requested by the Commission's December 23, 2002 Order Inviting Comments in this case, enclosed for filing please find the original and fifteen copies of the Comments by Allegheny Power.

Should there be any questions concerning these comments, please contact me.

Very truly yours,


Philip J. Bray
Attorney

cc: Preliminary Service List

WJ FEB -7 P 12 21

DOCUMENT CONTINUED

Before the
State Corporation Commission
of Virginia

Ex Parte: In the matter concerning *
the provision of default service to *
retail customers under the provisions * Case No. PUE- 2002-00645
of the Virginia Electric Utility *
Restructuring Act *

Comments by Allegheny Power

On December 23, 2002 the Commission issued an order initiating this proceeding for purposes of investigating the provision of default service to retail customers under the provisions of the Virginia Electric Utility Restructuring Act ("Act"). In its order, the Commission posed thirteen specific questions for input and recommendations regarding the components of default service and the establishment of programs making such services available to retail customers. Allegheny Power ("AP" or "the Company") offers the following comments on the questions set forth in the Commission's order dated December 23, 2002.

Question 1: What should be the specific components of default service.

AP recommends that the Commission's consideration of default service be limited to the provision of generation service.

While it may be interpreted that the Act contemplates the potential for unbundling the default service obligation into multiple components, AP believes a more practical approach would be to limit default service to the provision of generation service, and then assign a single entity to arrange for the entire default service obligation. This would appear legally permissible under the Act.

The components of default service should include unbundled energy, capacity, generation-related ancillary services, transmission and distribution losses and congestion associated with the provision of the foregoing services required to meet the hourly, daily and seasonal load obligations, including fluctuations associated with customer demand changes and decisions to switch generation suppliers. The provision of competitive default service entails fulfillment of all obligations associated with these services,

including the applicable obligations of a Load Serving Entity under the PJM Tariff, procedures, agreements and manuals.

AP realizes the Commission's immediate focus is on determining the components of default service, but as the Commission moves forward in its investigation exploring the competitive bid of default service AP looks forward to sharing its recent experiences with default service in Maryland and Ohio. Of specific interest in Maryland is the Settlement Agreement negotiated in Case No. 8908, *Standard Offer Service*. This settlement between Maryland's utilities, the Maryland PSC Staff, consumer groups and various wholesale and retail suppliers defines a procedure for the provision of default service to customers through the competitive selection of wholesale supply. The settlement makes such services available at market prices, benefiting all stakeholders. Customers are afforded protections beyond the assurances required by Maryland's restructuring statute, while permitting utilities to recover their verifiable, prudently incurred costs to procure the electricity plus a reasonable return. Retail suppliers are allowed to effectively compete for load, thereby stimulating the competitive market with no penalty to customers. Phase I of this settlement is pending approval by the MD PSC, and Phase II negotiations are in progress.

In Ohio, AP's capped Standard Service Offer will expire on December 31, 2003 for its large industrial customers. Therefore, Allegheny plans to file in February a plan to procure market-based default service via a competitive wholesale bidding process consistent with the proposed Competitive Bidding Process proposed by the Public Utility Commission of Ohio. As the Commission develops its recommendations on this important issue, AP looks forward to offering its experience with default service in both Maryland and Ohio.

Question 2: Whether, given the virtual absence of competition in Virginia's retail generation market, incumbent electric utilities should continue to provide default service at capped rates at the present time; if so, what changes in statute, policy, infrastructure, market conditions, and/or other circumstances are necessary to allow for the practical provision of default service by an entity other than the incumbent?

AP believes that the incumbent electric utilities are the most appropriate providers of default service. AP supports a wholesale bidding model as opposed to retail bidding for the procurement of electric supply associated with such service.

In continuing to offer default service, four basic objectives should be accomplished:

1. Default service should be a "safety-net" service to assure that generation service is available to all customers and all customer classes, including those customers that are unable to contract with or have been refused service by alternate generation suppliers.
2. Default service should be priced at market-based rates that are reflective of the total cost to provide this service, including non-commodity related costs necessary to provide default service.

3. The default service provider should be appropriately compensated for “stand-ready” costs such as customer care functions, assuring that the necessary infrastructure will remain in place to serve customers and provide safety-net service.
4. Default service should be regulated by the Commission.

Further, AP objects to any extension of current rate caps beyond the prescribed transition periods. AP agrees that the utility should be the continued provider of default service beyond the transition period, however, at market-based rates.

Question 3: What should be the geographic scope of a default service provider’s territory, i.e. statewide, incumbent utility service territory, regions served by specific transmission entities; divisions with an incumbent utility’s service territory; major metropolitan and surrounding areas, etc.

The geographic scope of a default service provider’s territory should be limited to the incumbent utility’s service territory within Virginia.

Question 4: Whether default service, as contemplated by § 56-585 of the Act, should be limited to unregulated services, i.e. is it necessary to designate distribution service as a default service?

Default service as contemplated by § 56-585 of the Act should be limited to unregulated generation service. The Act is clear in this regard, as provided for in § 56-577 A 3: “On and after January 1, 2002, the generation of electric energy shall no longer be subject to regulation under this title, except as specified in this chapter.” In addition, § 56-580 A provides: “The Commission shall continue to regulate pursuant to this title the distribution of retail electric energy to retail customers in the Commonwealth and, to the extent not prohibited by federal law, the transmission of electric energy in the Commonwealth.”

Most notably, § 56-580 E of the Act specifically provides for the incumbent electric utilities to retain their rights to serve within their service territories: “Nothing in this section shall impair the distribution service territorial rights of incumbent electric utilities, and incumbent electric utilities shall continue to provide distribution services within their exclusive service territories as established by the Commission.”

Question 5: For generation-related default service, whether the separate components of generation service to retail customers (capacity or resource reservation, energy, transmission, and ancillary services) should be treated as separate default services or bundled into a single service.

These components should be bundled into a single service, as discussed in AP’s response to Question 1.

Question 6: For generation-related default service, whether the service should be delivered to the retail customer or to the incumbent utility.

As previously discussed, AP believes that the incumbent electric utility is the most appropriate provider of default service. While AP supports a wholesale bidding model for the procurement of electric supply used to satisfy default service, the Company does not support a retail-bidding model under which an alternative supplier would deliver default service directly to the retail customer. AP views the Act as permitting wholesale bidding and procurement of default service but not the retail bidding and procurement of such service. AP is a "Distributor" and an "Incumbent Electric Utility" as defined by §56-576 of the Act. It is also a "public utility" as defined by §56-265.1 of Virginia's public service commission law and enjoys a certificate of public convenience and necessity to provide retail service within its designated service area under §56-265.3. While the term "Supplier" is defined by the statute (§56-576) to include selling "electric energy to retail customers" other provisions of the Act make clear that the incumbent electric utility or distributor retains its rights to provide retail service to customers in its designated service area. §56-580 E of the Act specifically provides: "Nothing in this section shall impair the distribution service territorial rights of incumbent electric utilities, and incumbent electric utilities shall continue to provide distribution services within their exclusive service territories as established by the Commission." The conclusion that incumbent electric utilities are to retain their rights to serve within their service territories is reinforced in §56-585 of the Act relating to default service which provides that the Commission can require an incumbent electric utility or distribution utility to provide default service but only in the service territory in which the utility provides service.

In addition, experience shows that retail bidding potentially results in some customers being assigned to retail suppliers without proper customer consent, which is clearly a form of customer "slamming" and is not permitted under the provisions of the Act.

Question 7: Whether the language of the statute prohibits the provision of default service to an incumbent utility on behalf of a group of customers, i.e. could a third party provide service to an incumbent utility for indirect service to retail customers (service to satisfy load growth, specific localities, or to customer subgroups).

While §56-589 of the statute provides for municipal and state aggregation, AP believes the Act does not specifically address the form of aggregation described above.

Question 8: Whether the provision of default services should differ by customer class.

Yes, the provision of default service should differ by customer classes. It appears that the Act contemplates this, as §56-585 E provides: "On or before July 1, 2004, and annually thereafter, the Commission shall determine, after notice and opportunity for hearing, whether there is a sufficient degree of competition such that the elimination of default service for particular customers, particular classes of customers or particular geographic

areas of the Commonwealth will not be contrary to the public interest.” The Act contemplates eliminating default service on a customer class basis, so AP interprets this as allowing the provision of default service to also differ by class.

With respect to commercial and industrial customers, in no event should default service provide a mechanism for more sophisticated customers to advantage themselves in the marketplace or exploit default service by arbitraging the market against the default service rate. Such customers are neither customers who cannot choose or choose not to participate in the market and therefore should not have the protection of default service under these circumstances. There are potentially numerous industrial and commercial customers who lack this level of sophistication and are very much in need of safety net service, but may not be readily distinguishable by size or by rate class. Therefore, although establishing size criteria for default service eligibility may administratively be the simplest approach, it may fail to appropriately encapsulate those customers in need of safety net services. Similar inequities may result if eligibility for default service is limited by current rate schedules for commercial and industrial customers. Provided that the potential for abuse of default service is addressed, AP recommends that all residential, commercial and industrial customers be eligible for some type of default service.

Question 9: Whether different components of default service can be provided by different suppliers.

As noted in the responses to Questions 1 and 5, AP believes the components of default service should be bundled and all components of default service should be provided by each supplier serving blocks or percentages of the default service load. AP supports a wholesale bidding model, whereby wholesale suppliers are eligible to serve default service load through wholesale competitive bidding processes for some or all of the default service requirements of a utility.

Assuming that a wholesale approach is employed in the provision of default service, the default service provider could satisfy its obligations through a competitive bid for full-requirements products from the wholesale market.

Full requirements service is defined as firm generation service, including all necessary energy, capacity, transmission, ancillary services, transmission and losses required to meet the hourly, daily and seasonal load fluctuations associated with customer demand changes and decisions to switch generation suppliers. Procurement of such full-requirements supply should be accomplished through a competitive bidding process. Potential suppliers will be provided with a comprehensive RFP describing the nature of the product, the supply requirements, supplier requirements, and all other information needed to appropriately inform the suppliers of their obligations, successfully award the bids and commence service. Blocks of service or percentages of load awarded will be on a lowest price basis with offers being excepted until such time that all 100% of default service load is awarded for suppliers that meet the RFP requirements.

Question 10: Whether default service has the same meaning for different classes of customers, i.e., those who do not affirmatively select a supplier, those who are unable to obtain service from an alternative supplier, or those who have contracted with an alternative supplier who fails to perform.

AP interprets the Act to provide for the same meaning with regard to default service for each of these customer groups.

Question 11: How should charges for default service be collected.

Default service should be billed and collected by the distribution entity, that is, the incumbent utility. The structure of the competitive bid (either a single rate or a more traditional retail pricing structure) may be used to determine the manner in which the distributor would bill customers.

Question 12: Whether metering, billing and collecting services should be deemed components of default service.

Although §56-581.1 of the Act provides for competitive metering and billing, AP does not view meter reading and billing as being required components of default service and subject to competitive bidding along with the generation component. Indeed, customers may now shop for and obtain these services from a competitive service provider. However, these services should not be required components of default service. As the work groups charged with establishing rules for competitive metering and billing have discovered, there are many complex issues surrounding each of these functions. In light of these facts, AP recommends that the Commission limit its consideration of default service solely to the provision of generation services.

Question 13: What implications would the alternative provision of default service have for the determination of wires charges?

The Act provides for just and reasonable stranded costs to be recovered by a utility through either capped rates or wires charges, as provided for in §56-583. As part of its restructuring settlement, AP has agreed not to assess a wires charge, and consequently declines to comment on this matter.

In closing, AP appreciates the opportunity to offer its views and recommendations on this subject matter. The Company looks forward to working with Staff and other interested parties to further develop and refine the Commission's recommendations on this important issue.

Preliminary Service List
Va. SCC Case No. PUE-2002-00645

Dan Carson, President
American Electric Power
Three James Center, Suite 702
1051 East Cary Street
Richmond, Va. 23219

Anthony Gambardella, Esq.
Woods, Rogers & Hazlegrove
823 East Main Street, Suite 1200
Richmond, Va. 23219

Mack Wathen
Director, Planning, Finance and Regulation
Conectiv Power Delivery
New Castle Regional Office
401 Eagle One Road
P. O. Box 9239
Newark, Delaware 19714

E. Paul Hilton
Sr. Vice President
Dominion Virginia Power
P. O. Box 26666
Richmond, Va. 23216

Ronald L. Willhite
Director, Rates
Kentucky Utilities
P. O. Box 32030
Louisville, Ky. 40232

T. N. Chryssikos, Esq.
Washington Energy Services
13865 Sunrise Valley Dr., Suite 200
Herndon, Va. 20171

Karen L. Bell, Esq.
Dominion Virginia Power
One James River Plaza, 14th Floor
701 East Cary Street
Richmond, Va. 23219

Thomas B. Nicholson, Esq.
Two James Center
1021 East Cary Street
Richmond, Va. 23219

John A. Pirko, Esq.
LeClair, Ryan
Innsbrook Corporate Center
4201 Dominion Blvd., Suite 200
Gen Allen, Va. 23060

Guy T. Tripp, Esq.
Hunton & Williams
Riverfront Plaza, East Tower
951 East Byrd Street
Richmond, Va. 23219

Christie A. McCormick, Esq.
Office of the Attorney General
900 E. Main Street
Richmond, Va. 23219

Edward L. Petrini, Esq.
Christian, Barton
909 East Main Street, Suite 1200
Richmond, Va. 23219